FIRST RELIANCE BANCSHARES INC
Form 10-Q
May 15, 2007

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.

FORM 10-Q

(Mark One)

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2007

OR

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _________to_________

Commission File Number 000-49757

FIRST RELIANCE BANCSHARES, INC.
(Exact name of small business issuer as specified in its charter)

South Carolina (State or other jurisdiction of incorporation or organization)	80-0030931 (I.R.S. Employer Identification No.)

2170 West Palmetto Street
Florence, South Carolina 29501
(Address of principal executive offices, including zip code)

(843) 656-5000
(Issuer's telephone number, including area code)

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date:

3,435,628 shares of common stock, par value $0.01 per share, as of May 1, 2007

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

o Yes x No.

FIRST RELIANCE BANCSHARES, INC.

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FIRST RELIANCE BANCSHARES, INC.
Condensed Consolidated Balance Sheets

	March 31, 2007 (Unaudited)	December 31, 2006 (Audited)
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 8,838,605	$ 17,328,075
Federal funds sold	24,069,000	14,135,000
Total cash and cash equivalents	32,907,605	31,463,075
Securities available-for-sale	35,644,764	35,931,271
Nonmarketable equity securities	1,780,400	2,187,600
Investment in trust	310,000	310,000
Total investment securities	37,735,164	38,428,871
Loans held for sale	8,099,771	6,632,010
Loans receivable	376,786,671	353,491,036
Less allowance for loan losses	(4,134,062)	(4,001,881)
Loans, net	372,652,609	349,489,155
Premises and equipment, net	15,540,456	13,770,135
Accrued interest receivable	2,274,308	2,464,531
Other real estate owned	1,087,537	1,386,380
Cash surrender value life insurance	10,234,776	10,134,036
Other assets	3,015,590	2,442,529
Total assets	**$ 483,547,816**	**$ 456,210,722**
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing transaction accounts	$ 50,252,975	$ 42,107,434
Interest-bearing transaction accounts	31,372,785	33,243,099
Savings	79,117,431	78,831,730
Time deposits $100,000 and over	135,534,391	111,991,864
Other time deposits	112,034,558	106,763,956
Total deposits	408,312,140	372,938,083
Securities sold under agreement to repurchase	8,671,324	8,120,014
Advances from Federal Home Loan Bank	19,000,000	28,500,000
Junior subordinated debentures	10,310,000	10,310,000
Accrued interest payable	749,925	766,276
Other liabilities	1,405,008	1,483,086
Total liabilities	448,448,397	422,117,459
Shareholders' Equity		
Common stock, $0.01 par value; 20,000,000 shares authorized, 3,459,630 and 3,424,878 shares issued and outstanding at March 31, 2007 and December 31, 2006, respectively	34,596	34,249
Nonvested restricted stock	(112,946)	(66,131)
Capital surplus	25,567,900	25,257,814
Retained earnings	9,564,963	8,857,755
Accumulated other comprehensive income	44,906	9,576
Total shareholders' equity	35,099,419	34,093,263
Total liabilities and shareholders' equity	**$ 483,547,816**	**$ 456,210,722**

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.
Condensed Consolidated Statements of Income
(Unaudited)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Interest income		
Loans, including fees	$ 7,892,673	$ 6,397,688
Investment securities		
Taxable	234,334	270,349
Nontaxable	170,141	152,401
Federal funds sold	78,659	177,871
Other interest income	40,305	26,018
Total	8,416,112	7,024,327
Interest expense		
Time deposits over $100,000	1,392,470	1,060,179
Other deposits	2,187,668	1,544,759
Other interest expense	447,293	410,720
Total	4,027,431	3,015,658
Net interest income	4,388,681	4,008,669
Provision for loan losses	135,234	250,285
Net interest income after provision for loan losses	4,253,447	3,758,384
Noninterest income		
Service charges on deposit accounts	442,670	364,379
Gain on sale of mortgage loans	470,242	358,450
Brokerage fees	40,860	31,465
Credit life insurance commissions	3,299	6,429
Other charges, commissions and fees	74,463	59,766
Gain on sale of securities available for sale	1,021	-
Gain on sale of other real estate	9,365	-
Gain (loss) on sale of fixed assets	14,415	(14)
Other non-interest income	136,850	117,980
Total	1,193,185	938,455
Noninterest expenses		
Salaries and benefits	2,595,775	2,240,635
Occupancy expense	337,396	288,986
Furniture and equipment expense	190,661	162,578
Other operating expenses	1,381,410	1,193,086
Total	4,505,242	3,885,285
Income before taxes	941,390	811,554
Income tax provision	234,183	237,851
Net income	**$ 707,207**	**$ 573,703**
Basic earnings per share	$ 0.21	$ 0.17
Diluted earnings per share	$ 0.20	$ 0.16

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Shareholders' Equity and Comprehensive Income
For the Three Months Ended March 31, 2007 and 2006
(Unaudited)

	Common Stock Shares	**Stock Amount**	**Capital surplus**	**Non-vested restricted stock**	**Treasury stock**	**Retained earnings**	**Accumulated other comprehensive income**	**Total**
Balance, December 31, 2005	3,306,117	$ 33,061	$ 24,127,329	$ -	$(9,896)	$ 5,611,847	$ (111,706)	$29,650,635
Net income						573,703		573,703
Other comprehensive loss, net of tax benefit of ($37,236)							(72,281)	(72,281)
Comprehensive income								501,422
Issuance of shares to 404c plan	4,970	50	64,063					64,113
Non- vested restricted stock	6,796	68	100,066	(91,840)				8,294
Sale of treasury stock					9,896			9,896
Exercise of stock options	52,371	524	412,444					412,968
Balance, March 31, 2006	**3,370,254**	**$ 33,703**	**$ 24,703,902**	**$ (91,840)**	**$ -**	**$ 6,185,550**	**$ (183,987)**	**$30,647,328**
Balance, December 31, 2006	3,424,878	$ 34,249	$ 25,257,814	$ (66,131)	$ -	$ 8,857,755	$ 9,576	$ 34,093,263
Net income						707,208		707,208
Other comprehensive								

gain, net of tax expense of ($18,548)							35,330	35,330
Comprehensive income								742,538
Issuance of shares to 404c plan	9,750	97	143,715					143,812
Non- vested restricted stock	4,002	40	59,996	(46,815)				13,220
Exercise of stock options	21,000	210	106,375					106,585
Balance, March 31, 2007	**3,459,630**	**$ 34,596**	**$ 25,567,900**	**$ (112,946)**	**$ -**	**$ 9,564,963**	**$ 44,906**	**$ 35,099,419**

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31, 2007	2006
Cash flows from operating activities:		
Net income	$ 707,207	$ 573,703
Adjustments to reconcile net income to net cash used by operating activities:		
Provision for loan losses	135,234	250,286
Depreciation and amortization expense	170,029	213,759
Gain on sale of equipment	(14,415)	-
Gain on sale of OREO	(9,365)	-
Gain on sale of available-for-sale securities	(1,021)	-
Writedown of other real estate owned	-	20,000
Discount accretion and premium amortization	14,806	14,565
Deferred income tax benefit	(322,596)	(312,837)
Decrease (increase) in interest receivable	190,223	205,176
Decrease in interest payable	(16,351)	(10,930)
Disbursements for loans held for sale	(33,444,353)	(26,310,121)
Proceeds from loans held for sale	31,976,592	26,544,215
Increase in other assets	(418,985)	(4,929,340)
Decrease in other liabilities	(78,077)	110,720
Net cash used by operating activities	(1,111,072)	(3,630,804)
Cash flows from investing activities:		
Purchases of securities available-for-sale	(1,410,755)	(1,421,226)
Sale of securities available-for-sale	1,258,870	-
Net increase in loans receivable	(23,506,685)	(16,721,809)
Maturities of securities available-for-sale	478,138	1,063,350
Sales of other real estate owned	516,205	-
Purchase of non marketable equity securities	(407,300)	(435,500)
Proceeds on sale of nonmarketable equity securities	814,500	225,000
Proceeds from disposal of premises, furniture, and equipment	38,066	14,803
Purchases of premises and equipment	(1,914,422)	(774,155)
Net cash used by investing activities	(24,133,383)	(18,049,537)
Cash flows from financing activities:		
Net increase in demand deposits, interest-bearing transaction accounts and savings accounts	6,560,928	4,541,107
Net increase in certificates of deposit and other time deposits	28,813,129	16,127,807
Net increase in securities sold under agreements to repurchase	551,310	267,854
Decrease in advances from the Federal Home Loan Bank	(9,500,000)	(5,000,000)
Proceeds from issuance of shares to ESOP	143,812	64,113
Sale of treasury stock	-	9,896
Proceeds from the exercise of stock options	106,585	412,968
Issuance of restricted stock	13,221	8,294

Net cash provided by financing activities		26,688,985		16,432,039
Net increase (decrease) in cash and cash equivalents		1,444,530		(5,248,302)
Cash and cash equivalents, beginning		31,463,075		29,706,897
Cash and cash equivalents, end	**$**	**32,907,605**	**$**	**24,458,595**
Cash paid during the period for:				
Income taxes	$	12,383	$	137,522
Interest	$	4,043,782	$	3,026,588

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 1 - Basis of Presentation

The accompanying financial statements have been prepared in accordance with the requirements for interim financial statements and, accordingly, they are condensed and omit certain disclosures, which would appear in audited annual financial statements. The financial statements as of March 31, 2007 and for the interim periods ended March 31, 2007 and 2006 are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation. The financial information as of December 31, 2006 has been derived from the audited financial statements as of that date. For further information, refer to the financial statements and the notes included in First Reliance Bancshares, Inc.'s 2006 audited financial statements in Form 10-K.

Note 2 - Recently Issued Accounting Pronouncements

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and / or disclosure of financial information by the Company.

In February 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting ("SFAS") No. 155, "Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140." This Statement amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." This Statement resolves issues addressed in SFAS No. 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets." FAS 155 permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest only-strips and principal-only strips are not subject to the requirements of Statement 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after January 1, 2007. The Company does not believe that the adoption of SFAS No. 155 will have a material impact on its financial position, results of operations or cash flows.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140." This Statement amends FASB No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract; requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; permits an entity to choose its subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities; at its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value; and requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. The required adoption date for SFAS No. 156 is January 1, 2007. The Company does not believe the adoption of SFAS No. 156 will have a material impact on its financial position, results of operations or cash flows.

In July 2006, the FASB issued FASB Interpretation No. 48 (“FIN 48”), “Accounting for Uncertainty in Income Taxes”. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in enterprises’ financial statements in accordance with FASB Statement No. 109, “Accounting for Income Taxes”. FIN 48 prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not believe that FIN 48 will have a material impact on its financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This standard does not require any new fair value measurements, but rather eliminates inconsistencies found in various prior pronouncements. SFAS 157 is effective for the Company on January 1, 2008 and will not impact the Company’s accounting measurements but it is expected to result in some additional disclosures.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

In September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans” (“SFAS 158”), which amends SFAS 87 and SFAS 106 to require recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, gains and losses, prior service costs and credits, and any remaining transition amounts under SFAS 87 and SFAS 106 that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost. The measurement date — the date at which the benefit obligation and plan assets are measured — is required to be the company’s fiscal year end. SFAS 158 is effective for publicly−held companies for fiscal years ending after December 15, 2006, except for the measurement date provisions, which are effective for fiscal years ending after December 15, 2008. The Company does not have a defined benefit pension plan. Therefore, SFAS 158 will not impact the Company’s financial condition or results of operations.

In September 2006, the FASB ratified the consensuses reached by the FASB’s Emerging Issues Task Force (“EITF”) relating to EITF 06-4 “Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements”. EITF 06-4 addresses employer accounting for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods should recognize a liability for future benefits in accordance with SFAS No. 106, “Employers' Accounting for Postretirement Benefits Other Than Pensions”, or Accounting Principles Board (“APB”) Opinion No. 12, “Omnibus Opinion—1967”. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. Entities should recognize the effects of applying this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The Company is currently analyzing the effect of adoption of EITF 06-4 on its financial position, results of operations and cash flows.

In September 2006, the FASB ratified the consensus reached related to EITF 06-5, “Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance.” EITF 06-5 states that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. EITF 06-5 also states that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). EITF 06-5 is effective for fiscal years beginning after December 15, 2007. The Company is currently analyzing the effect of adoption of EITF 06-5 on its financial position, results of operations and cash flows.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115." This statement permits, but does not require, entities to measure many financial instruments at fair value. The objective is to provide entities with an opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Entities electing this option will apply it when the entity first recognizes an eligible instrument and will report unrealized gains and losses on such instruments in current earnings. This statement 1) applies to all entities, 2) specifies certain election dates, 3) can be applied on an instrument-by-instrument basis with some exceptions, 4) is irrevocable and 5) applies only to entire instruments. One exception is demand deposit liabilities which are explicitly excluded as qualifying for fair value. With respect to SFAS 115, available-for-sale and held-to-maturity securities at the effective date are eligible for the fair value option at that date. If the fair value option is elected for those securities at the effective date, cumulative unrealized gains and losses at that date shall be included in the cumulative-effect adjustment and thereafter, such securities will be accounted for as trading securities. SFAS 159 is effective for the Company on January 1, 2008. The Company is currently analyzing the fair value option that is permitted, but not required, under SFAS 159.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Note 3 - Equity Incentive Plan

During the first quarter of 2006, the Company adopted the 2006 Equity Incentive Plan. The 2006 Equity Incentive Plan provides for the granting of dividend equivalent rights, options, performance unit awards, phantom shares, stock appreciation rights, and stock awards of up to 350,000 shares of the Company's common stock to officers, employees, directors, consultants, and other service providers of the Company, or any Affiliate of the Company.

During the first quarter of 2007, the Company granted 62,481 stock appreciation rights. The Company granted 45,774 stock appreciation rights during the same period of 2006. A stock appreciation right entitles an individual to receive the excess of the fair market value from the grant date to the exercise date in a settlement of Company stock. The Company has funded the liability through charges to earnings. The accrued liability for the stock appreciation rights at March 31, 2007 was $38,010.

A summary of the status of the Company's stock appreciation rights as of the three months ended March 31, 2007 is presented below:

	Three months ended March 31, 2007		
	Shares		**Weighted Average Exercise Price**
Outstanding at January 1	45,501	$	14.87
Granted	62,481		15.00
Exercised	-		
Forfeited	-		
Outstanding at March 31, 2007	**107,982**	**$**	**14.95**

During the three months ended March 31, 2007, the Company granted 4,002 shares of restricted stock, pursuant to the 2006 Equity Incentive Plan. The Company granted 6,796 shares of restricted stock during the same period of 2006. The shares “cliff” vest in three years and are fully vested on March 28, 2010. The weighted average fair value of restricted stock granted in three months ended March 31, 2007 was $15.00. Compensation cost associated with the grant was $13,220 for the three months ended March 31, 2007.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 3 - Equity Incentive Plan, *continued*

A summary of the status of the Company's restricted stock as of the three months ended March 31, 2007 is presented below:

	Three months ended March 31, 2007		
	Shares		Weighted Average Exercise Price
Outstanding at January 1	6,771	$	14.86
Granted	4,002		15.00
Exercised	(2,225)		14.86
Forfeited	-		
Outstanding at March 31, 2007	**8,548**	**$**	**14.93**

Note 4 - Stock Compensation Plan

On June 19, 2003, the Company established the 2003 First Reliance Bank Employee Stock Option Plan (Stock Plan) that provides for the granting of options to purchase up to 250,000 shares of the Company's common stock to directors, officers, or employees of the Company. This plan was preceded by the 1999 First Reliance Bank Employee Stock Option Plan, which provided for the granting of options to purchase up to 238,000 shares of the Company's common stock to directors, officers, or employees of the Company. The per-share exercise price of incentive stock options granted under the Stock Plan may not be less than the fair market value of a share on the date of grant. The per-share exercise price of stock options granted is determined by the Board of Directors. The expiration date of any option may not be greater than ten years from the date of grant. Options that expire unexercised or are canceled become available for reissuance. At March 31, 2007, there were no options available for grant under the 2003 plan and no options available for grant under the 1999 plan.

A summary of the status of the Company's stock option plan as of the three months ended March 31, 2007 changes during the period is presented below:

	Three months ended March 31, 2007		
	Shares		Average Exercise Price
Outstanding at January 1	321,992	$	7.80
Granted	-		-
Exercised	(21,000)		5.08
Forfeited	-		-
Outstanding at March 31, 2007	**300,992**	**$**	**8.15**

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 5 - Earnings Per Share

A reconciliation of the numerators and denominators used to calculate basic and diluted earnings per share for the three month periods ended March 31, 2007 and 2006 are as follows:

	Three Months Ended March 31, 2007				
		Income (Numerator)	Shares (Denominator)		Per Share Amount
Basic earnings per share					
Income available to common shareholders	$	707,207	3,432,022	**$**	**0.21**
Effect of dilutive securities					
Stock options			117,374		
Non -vested restricted stock		-	193		
Diluted earnings per share					
Income available to common shareholders plus assumed conversions	**$**	**707,207**	**3,549,589**	**$**	**0.20**

	Three Months Ended March 31, 2006				
		Income (Numerator)	Shares (Denominator)		Per Share Amount
Basic earnings per share					
Income available to common shareholders	$	573,703	3,344,344	**$**	**0.17**
Effect of dilutive securities					
Stock options			189,979		
Non -vested restricted stock		-	362		
Diluted earnings per share					
Income available to common shareholders plus assumed conversions	**$**	**573,703**	**3,534,685**	**$**	**0.16**

Note 6 - Comprehensive Income

Comprehensive income includes net income and other comprehensive income, which is defined as nonowner related transactions in equity. The following table sets forth the amounts of other comprehensive income included in equity along with the related tax effect.

For the three months ended

	March 31,			
		2007		2006
Unrealized gains (losses) on securities available-for-sale:	$	53,531	$	(109,517)
Reclassification adjustment for gains realized in net income		1,021		-
Net unrealized gains (losses) on securities		54,552		(109,517)
Tax effect		(19,222)		37,236
Net-of-tax amount	**$**	**35,330**	**$**	**(72,281)**

Accumulated other comprehensive income (loss) consists solely of the unrealized gain (loss) on securities available-for-sale, net of the deferred tax effects.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 7 - Reclassifications

Certain captions and amounts in the March 31, 2006 10-Q were reclassified to conform with the March 31, 2007 presentation.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis or Plan of Operation

The following discussion of financial condition as of March 31, 2007 compared to December 31, 2006, and the results of operations for the three months ended March 31, 2007 compared to the three months ended March 31, 2006 should be read in conjunction with the condensed financial statements and accompanying footnotes appearing in this report.

Advisory Note Regarding Forward-Looking Statements

The statements contained in this report on Form 10-Q that are not historical facts are forward-looking statements subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. We caution readers of this report that such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of us to be materially different from those expressed or implied by such forward-looking statements. Although we believe that our expectations of future performance is based on reasonable assumptions within the bounds of our knowledge of our business and operations, there can be no assurance that actual results will not differ materially from our expectations.

Factors which could cause actual results to differ from expectations include, among other things:

- the challenges, costs and complications associated with the continued development of our branches;
- the potential that loan charge-offs may exceed the allowance for loan losses or that such allowance will be increased as a result of factors beyond the control of us;
- our dependence on senior management;
- competition from existing financial institutions operating in our market areas as well as the entry into such areas of new competitors with greater resources, broader branch networks and more comprehensive services;
- adverse conditions in the stock market, the public debt market, and other capital markets (including changes in interest rate conditions);
- changes in deposit rates, the net interest margin, and funding sources;
- inflation, interest rate, market, and monetary fluctuations;
- risks inherent in making loans including repayment risks and value of collateral;
- the strength of the United States economy in general and the strength of the local economies in which we conduct operations may be different than expected resulting in, among other things, a deterioration in credit quality or a reduced demand for credit, including the resultant effect on our loan portfolio and allowance for loan losses;
- fluctuations in consumer spending and saving habits;
- the demand for our products and services;
- technological changes;
- the challenges and uncertainties in the implementation of our expansion and development strategies;

- the ability to increase market share;
- the adequacy of expense projections and estimates of impairment loss;
- the impact of changes in accounting policies by the Securities and Exchange Commission;
- unanticipated regulatory or judicial proceedings;
- the potential negative effects of future legislation affecting financial institutions (including without limitation laws concerning taxes, banking, securities, and insurance);
- the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System;
- the timely development and acceptance of products and services, including products and services offered through alternative delivery channels such as the Internet;
- the impact on our business, as well as on the risks set forth above, of various domestic or international military or terrorist activities or conflicts;
- other factors described in this report and in other reports we have filed with the Securities and Exchange Commission; and
- our success at managing the risks involved in the foregoing.

Forward-looking statements speak only as of the date on which they are made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made to reflect the occurrence of unanticipated events.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - *continued*

Overview

First Reliance Bank (the "Bank") is a state-chartered bank headquartered in Florence, South Carolina. The Bank opened for business on August 16, 1999. The principal business activity of the Bank is to provide banking services to domestic markets, principally in Florence County, Lexington County, Charleston County, Greenville County, and York County South Carolina. The deposits of the Bank are insured by the Federal Deposit Insurance Corporation.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - *continued*

Like most community banks, we derive the majority of our income from interest received on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowings. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities, which is called our net interest spread.

There are risks inherent in all loans, so we maintain an allowance for loan losses to absorb probable losses on existing loans that may become uncollectible. We maintain this allowance by charging a provision for loan losses against our operating earnings for each period. We have included a detailed discussion of this process, as well as several tables describing our allowance for loan losses.

In addition to earning interest on our loans and investments, we earn income through fees and other charges to our customers. We have also included a discussion of the various components of this non-interest income, as well as of our non-interest expense.

The following discussion and analysis also identifies significant factors that have affected our financial position and operating results during the periods included in the accompanying financial statements. We encourage you to read this discussion and analysis in conjunction with our financial statements and the other statistical information included in our filings with the Securities and Exchange Commission.

Critical Accounting Policies

We have adopted various accounting policies which govern the application of accounting principles generally accepted in the United States in the preparation of our financial statements. Our significant accounting policies are described in the notes to the consolidated financial statements at December 31, 2006 as filed on our annual report on Form 10-K. Certain accounting policies involve significant judgments and assumptions by us which have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgments and assumptions we use are based on the historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgments and assumptions we make, actual results could differ from these judgments and estimates which could have a major impact on our carrying values of assets and liabilities and our results of operations.

We believe the allowance for loan losses is a critical accounting policy that requires the most significant judgments and estimates used in preparation of our consolidated financial statements. Refer to the portion of this discussion that addresses our allowance for loan losses for description of our processes and methodology for determining our allowance for loan losses.

Regulatory Matters

We are not aware of any current recommendations by regulatory authorities which, if they were to be implemented, would have a material effect on liquidity, capital resources or operations.

Effect of Economic Trends

Economic conditions, competition and federal monetary and fiscal policies also affect financial institutions. Lending activities are also influenced by regional and local economic factors, such as housing supply and demand, competition among lenders, customer preferences and levels of personal income and savings in our primary market area.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - *continued*

Results of Operations

Income Statement Review

Three months ended March 31, 2007 and 2006:

Our net income was $707,207 and $573,703 for the three months ended March 31, 2007 and 2006, respectively, an increase of $133,504, or 23.3%. The $133,504 increase in net income resulted primarily from an increase of $380,012 in net interest income and $254,730 in non-interest income which was partially offset by an increase of $619,957 in noninterest expense.

Net Interest Income

Our level of net interest income is determined by the level of earning assets and the management of our net interest margin. The continuous growth in our loan portfolio is the primary driver of the increase in net interest income. During the three months ended March 31, 2007, our average loan portfolio increased $43.0 million compared to the average for the three months ended March 31, 2006. We anticipate the growth in loans will continue to drive the growth in assets and the growth in net interest income. However, no assurance can be given that we will be able to continue to increase loans at the same levels we have experienced in the past.

Our decision to grow the loan portfolio at the current pace created the need for a higher level of capital and the need to increase deposits and borrowings. This loan growth strategy also resulted in a significant portion of our assets being in higher earning loans than in lower yielding investments. At March 31, 2007, loans represented 77.9% of total assets, while investments represented 7.8% of total assets. While we plan to continue our focus on increasing the loan portfolio, as rates on investment securities begin to rise and additional deposits are obtained, we also anticipate increasing the size of the investment portfolio.

The historically low interest rate environment in the last three years allowed us to obtain short-term borrowings and wholesale certificates of deposit at relatively low rates. We continue to aggressively target core deposit growth by offering the best in market deposit and loan rates. This, along with our successful marketing campaigns and cross selling, is producing a more seasoned deposit base. At March 31, 2007, retail deposits represented $257.8 million, or 53.3% of total assets, borrowings represented $29.3 million, or 6.1% of total assets, and non-core deposits represented $150.5 million, or 36.9% of total assets.

As more fully discussed in the - "Market Risk" and - "Liquidity and Interest Rate Sensitivity" sections below, at March 31, 2007, 62.3% of our loans had variable rates. Given our high percentage of rate-sensitive loans, our primary focus during the past three years has been to obtain short-term liabilities to fund our asset growth. This strategy improves our ability to manage the impact on our earnings resulting from anticipated increases in market interest rates.

At March 31, 2007, 88.6% of interest-bearing liabilities had a maturity of less than one year. At March 31, 2007, we had $25.9 million more liabilities than assets that reprice within the next three months.

We intend to maintain a capital level for the bank that exceeds requirements to be classified as a "well capitaliz